UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MONTANA

In re **DUANE PATRICK SAUTER**, and **JULIA MARIE SAUTER**, Debtors.	Case No. **04-63077-7**
COLLECTION BUREAU SERVICES, INC., Plaintiff, -vs- **DUANE PATRICK SAUTER,** and **JULIA MARIE SAUTER**, Defendants.	Adv No. **04-00140**

MEMORANDUM OF DECISION

At Butte in said District this 2nd day of May, 2005.

On April 15, 2005, Plaintiff filed a motion for summary judgment, including therein an abbreviated statement of uncontroverted facts. The statement of uncontroverted facts is not entirely in compliance with Mont. LBR 7056-1, as the statement does not "specify the specific portion of the record where [each] fact can be found." *See* statement numbers 5, 7 and 8.

On April 25, 2005, Defendants filed a response in opposition to summary judgment and requested a hearing for May 5, 2005, at 1:30 p.m., in Missoula, Montana. Given an error in the docket text, Defendants were instructed to resubmit the filing to correct the hearing information.

On April 26, 2005, Defendants refiled their response in opposition to summary judgment, together with an affidavit by Julia Sauter, and requested a hearing for May 5, 2005, at 1:30 p.m., in Missoula, Montana. Defendants' response and statement of genuine issues admit the facts contained in statement numbers 1, 2, 6, 7, 8, 9. Defendants dispute they provided Ms. Kelly with a certificate of liability insurance and contend that an insurance company representative provided Ms. Kelly with a certificate of liability insurance. Statement no. 3. Defendants dispute that Ms. Kelly relied on the representation that a certificate of liability insurance existed. Statement no. 4. Defendants deny the "workmanship was very poor." Statement no. 5. Defendants admit that a default judgment was entered that conforms to the statement contained in Plaintiff's statement number 8.

APPLICABLE LAW

A. Standard For Summary Judgment

Summary judgment is governed by F.R.B.P. 7056. Rule 7056, incorporating F.R.Civ.P. 56(c), states that summary judgment "shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Notwithstanding, "[t]he proponent of a summary judgment motion bears a heavy burden to show that there are no disputed facts warranting disposition of the case on the law without trial." *Younie v. Gonya (In re Younie)*, 211 B.R. 367, 372 (9th Cir. BAP 1997) (quoting *In re Aquaslide "N" Dive Corp.*, 85 B.R. 545, 547 (9th Cir. BAP 1987), *aff'd* 163 F.3d 609 (9th Cir. 1998). Once that burden has been met, "the opponent must affirmatively show that a material issue of fact remains in dispute". *Frederick S. Wyle P.C. v. Texaco, Inc.*, 764 F.2d

604, 608 (9th Cir.1985). That is, the opponent cannot assert the "mere existence of some alleged factual dispute between the parties." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). Instead, to demonstrate that a genuine factual issue exists, the objector must produce affidavits which are based on personal knowledge. *Aquaslide*, 85 B.R. at 547. Additionally, the facts set forth therein must be admissible into evidence. *Id*.

To prevail on a motion for summary judgment, the moving party must first identify those portions of the record before the Court which it believes establish an absence of material fact. *T.W. Elec. Service, Inc. v. Pacific Elec. Contractors Ass'n.*, 809 F.2d 626, 630 (9th Cir. 1987). If the moving party adequately carries its burden, the party opposing summary judgment must then "set forth specific facts showing that there is a genuine issue for trial." *Kaiser Cement Corp. v. Fischback & Moore, Inc.*, 793 F.2d 1100, 1103-04 (9th Cir. 1986), *cert. denied*, 469 U.S. 949, 107 S.Ct. 435, 93 L.Ed.2d 384 (1986). As explained by the U.S. Supreme Court, a mere "scintilla" of evidence supporting the opposing party's position will not suffice; there must be enough of a showing that a jury could reasonably find for that party. *Anderson*, 477 U.S. 242.

All reasonable doubt as to the existence of genuine issues of material fact must be resolved against the moving party. *Anderson*, 477 U.S. 242. Nevertheless, "[d]isputes over irrelevant or unnecessary facts will not preclude a grant of summary judgment." *T.W. Elec. Serv.*, 809 F.2d at 630 (citing *Anderson*, 477 U.S. at 248). "A 'material' fact is one that is relevant to an element of a claim or defense and whose existence might affect the outcome of the suit. The materiality of a fact is thus determined by the substantive law governing the claim or defense." *Id*.

If a rational trier of fact might resolve disputes raised during summary judgment proceedings in favor of the nonmoving party, summary judgment must be denied. *Matsushita*

Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). Thus, the Court's ultimate inquiry is to determine whether the "specific facts" set forth by the nonmoving party, viewed along with the undisputed background or contextual facts, are such that a rational or reasonable jury might return a verdict in its favor based on that evidence. *T.W. Elec. Serv.*, 809 F.2d at 631.

B. Dischargeability of a Debt.

In a nondischargeability claim the burden of proof falls on the creditor to prove the elements by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291, 111 S.Ct. 654, 661, 112 L.Ed.2d 755 (1991) ("we hold that the standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard."); *In re Branam*, 226 B.R. 45, 52 (9th Cir. BAP 1998), *aff'd*, 205 F.3d 1350 (9th Cir. 1999). A creditor's burden, in conjunction with the "fresh start" policy of the Bankruptcy Code, creates a sizeable obstacle for creditors to overcome in order to prevail on a nondischargeability complaint. *In re Tyler*, 19 Mont. B.R. 441, 447 (Bankr. D. Mont. 2002); *In re Ballew*, 18 Mont. B.R. 404, 410-11 (Bankr. D. Mont. 2000). As the Ninth Circuit Court of Appeals stated:

> One of the fundamental policies of the Bankruptcy Code is the fresh start afforded debtors through the discharge of their debts. *In re Devers*, 759 F.2d 751, 754-55 (9th Cir. 1985). In order to effectuate the fresh start policy, exceptions to discharge should be strictly construed against an objecting creditor and in favor of the debtor. *In re Klapp*, 706 F.2d 998, 999 (9th Cir. 1983).

Snoke v. Riso (In re Riso), 978 F.2d 1151, 1154 (9th Cir. 1992); *see also In re Kidd*, 219 B.R. 278, 282, 16 Mont. B.R. 382, 386 (Bankr. D. Mont. 1998). Under this authority, Plaintiff has the burden of proof under § 523(a), a sizeable obstacle which the Court must strictly construe against Plaintiff and in favor of Defendant.

C. Dischargeability of a Debt under § 523(a)(2)(A).

To establish nondischargeability as a result of fraud under § 523(a)(2)(A)[1], courts in the Ninth Circuit employ the following five-element test, which requires that each element be proven by a preponderance of the evidence:

> (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor;
> (2) knowledge of the falsity or deceptiveness of [debtor's] statement or conduct;
> (3) an intent to deceive;
> (4) justifiable reliance by the creditor on the debtor's statement or conduct; and
> (5) damage to the creditor proximately caused by [creditor's] reliance on the debtor's statement or conduct.

Harmon v. Kobrin (In re Harmon), 250 F.3d 1240, 1246 (9th Cir. 2001); *Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman),* 234 F.3d 1081, 1085 (9th Cir. 2000); *American Express Travel Related Services Co., Inc., v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1125, *cert. denied*, 520 U.S. 1230, 117 S.Ct. 1824, 137 L.Ed.2d 1031 (1997); *Citibank (South Dakota), N.A., v. Eashai (In re Eashai)*, 87 F.3d 1082, 1086 (9th Cir. 1996); *Apte v. Japra, M.D., F.A.C.C., Inc. (In re Apte)*, 96 F.3d 1319, 1322 (9th Cir. 1996); *Sparks v. King (In re King)*, 258 B.R. 786, 794 (Bankr. D. Mont. 2001); *Ballew*, 18 Mont. B.R. at 412-13.

In considering the

> . . . second element, a misrepresentation is made with fraudulent intent if the

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[1] 11 U.S.C. § 523(a)(2)(A) reads:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt–
>
> * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by–
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

> maker knows or believes that his statements are false. RESTATEMENT § 526[[2]]; *Diduck v. Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 276 (2d Cir.1992). Accordingly, non-dischargeability under § 523(a)(2)(A) requires a finding of actual or positive fraud as opposed to fraud implied by law. *Palmacci v. Umpierrez*, 121 F.3d [781, 788 (1st Cir. 1997)]; [*Weiss v. Alicea (In re Alicea)*, 230 B.R. 492, 500 (Bankr. S.D.N.Y. 1999]; *see* 124 Cong. Rec. H11096 (daily ed. Sept. 28, 1978)(statement of Rep. Edwards); 124 Cong. Rec. S17412 (daily ed. Oct. 6, 1978)(statement of Sen. DeConcini). The party asserting nondischargeability must prove an actual intent to mislead; proof of mere negligence is not enough because the " 'dumb but honest' defendant does not satisfy the test of scienter." *Palmacci v. Umpierrez*, 121 F.3d at 788; *accord* RESTATEMENT § 526 cmt. d (1965)("The fact that the misrepresentation is one that a man of ordinary care and intelligence in the maker's situation would have recognized as false is not enough to impose liability upon the maker for a fraudulent misrepresentation under the rule stated in this Section, but it is evidence from which his lack of honest belief may be inferred.").

Morris, 252 B.R. at 48.

> The fourth element, reliance, requires that such reliance is justifiable, not reasonable.

Apte, 96 F.3d at 1322.

> Justification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of a particular case, rather than of the application of a community standard of conduct to all cases. . . . [A] person is 'required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation. . . .

Fields v. Mans, 516 U.S. at 71, 116 S.Ct. at 444 (1995).

This Court explained in *Tyler*:

> The determination of non-dischargeability under § 523(a)(2)(A) is a question of federal, not state law and since the elements of the § 523(a)(2)(A) test mirror the common law elements of fraud, courts must interpret these elements consistent with the common law definition of "actual fraud" as set forth in the Restatement (Second) of Torts (1976) §§ 525-557A. *Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 443-44, 133 L.Ed.2d 351 (1995) (""false pretenses, a false representation, or

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[2] Under RESTATEMENT § 526, fraudulent intent also includes a misrepresentation made without confidence in its accuracy or without any basis.

> actual fraud,'...are common-law terms, and...in the case of 'actual fraud,'...they imply elements that the common law has defined them to include.").

Tyler, 19 Mont. B.R. at 448-49, quoting *Ballew*, 18 Mont. B.R. at 413.

In considering the nondischargeability of a debt arising through fraud under 11 U.S.C. § 523(a)(2)(A), one must consider the nature of the transaction. "Traditional credit transactions are two-party transactions between the debtor and the creditor." *Slyman*, 234 F.3d at 1086, quoting *Eashai*, 87 F.3d at 1087. These traditional credit transactions are in contrast to credit card transactions, which "involve three-parties: 1) the debtor/card holder; 2) the creditor/card issuer; and 3) the merchant who honors the credit card. The difficulty in credit card cases is for the creditor, who does not deal face-to-face with the debtor, to prove the elements of misrepresentation and reliance." *Id.* In three party transactions, the panel in *Eashai* adopted the totality of circumstances theory, wherein "a court may infer the existence of the debtor's intent not to pay if the facts and circumstances of particular case present a picture of deceptive conduct by the debtor." *Eashai*, 87 F.3d at 1087. The "totality of circumstances" theory is one of three theories applied in three-party transactions. The other two theories are the majority approach or "implied representation" theory and the minority approach or "assumption of the risk" theory. *Id.* Under the totality of circumstances theory, *Eashai* adopts the twelve factors[3] from *In re*

[3] The factors are: (1) the length of time between the charges made and the filing of bankruptcy; (2) whether or not an attorney has been consulted concerning the filing of bankruptcy before the charges were made; (3) the number of charges made; (4) the amount of the charges; (5) the financial condition of the debtor at the time the charges are made; (6) whether the charges were above the credit limit of the account; (7) whether the debtor made multiple charges on the same day; (8) whether or not the debtor was employed; (9) the debtor's prospects for employment; (10) financial sophistication of the debtor; (11) whether there was a sudden change in the debtor's buying habits; and (12) whether the purchases were made for luxuries or necessities. *Eashai*, 87 F.3d at 1087-88 (citing *In re Dougherty*, 84 B.R. 653, 657 (9th Cir. BAP 1988), which was abrogated on other grounds).

Dougherty, 84 B.R. 653 (9th Cir BAP 1988), "to establish the element of intent to deceive," or the "subjective intent of the debtor through circumstantial evidence" plus the elements of justifiable reliance and causation of damages. *Eashai*, 87 F.3d at 1088-90.

Eashai permits credit card companies to establish misrepresentation and reliance by reference to the totality of circumstances and does not require strict evidentiary proof of misrepresentation and reliance. *Slyman*, 234 F.3d at 1086.

> . . . [[T]wo-party credit] transactions do not bear the distinguishing characteristic of [three-party] transactions. Transactions between a credit card holder and a credit card company are intermediated by a third-party vendor. Transactions between a [debtor] and a [creditor], by contrast, are direct and without intermediation. Accordingly, we decline to apply the totality of the circumstances test to [two-party] transactions. A [creditor] must prove the elements of misrepresentation and reliance directly and by a preponderance of the evidence.

Id. Inferential existence of intent to deceive cannot be established in a two-party transaction under the totality of circumstances approach, wherein facts and circumstances of a particular case are used to determine deceptive conduct of a debtor. *Slyman*, 234 F.3d at 1086. This Court in three prior cases when discussing the nondischargeability of a debt under 11 U.S.C. § 523(a)(2)(A) in two-party transactions made references not only to direct evidence but also to considering the facts and circumstances of a particular case to determine through inference if deceptive conduct by the debtor occurred. *See Money Lenders v. Tyler (In re Tyler)*, 19 Mont. B.R. 441, 450 (Bankr. D. Mont. 2002), *Sparks v. King (In re King)*, 258 B.R. 786, 794-95 (Bankr. D. Mont. 2001), and *Ballew v. Ballew (In re Ballew)*, 18 Mont. B.R. 404, 414 (Bankr. D. Mont. 2000). Given the holding in *Slyman* regarding the need for direct evidence in two-party transactions, the reference in the above cited cases to, in essence, a totality of circumstances approach is in error. However, the Court, in *Tyler*, *King*, and *Ballew*, based its decision on the

direct evidence, or lack thereof, and did not determine the outcome in such cases solely by applying the totality of circumstances approach.

D. Collateral Estoppel – Default Judgment – Actually Litigated.

"[C]ollateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)." *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S.Ct. 654 (1991). "A federal court, including a bankruptcy court, must accord a state court judgment the same preclusive effect it would be accorded by the rendering state." *Taub v. Morris (In re Morris)*, 252 B.R. 41, 47 (Bankr. S.D.N.Y. 2000). *See also Cal-Micro, Inc., v. Cantrell (In re Cantrell)*, 329 F.3d 1119, 1123 (9th Cir. 2003) and *Gayden v. Nourbakhsh (In re Nourbakhsh)*, 67 F.3d 798, 800 (9th Cir. 1995).

In Montana, the supreme court has adopted "a three-part test for determining whether collateral estoppel applie[s]: (1) was the issue decided in the prior adjudication identical with the one presented in the action in question? (2) was there a final judgment on the merits? (3) was the party against whom the plea is asserted a party or in privity with a party to the prior adjudication? *Aetna*, 207 Mont. at 413, 673 P.2d at 1279." *Lane v. Farmers Union Ins.*, 1999 MT 252, 279, 296 Mont. 267, 989 P.2d 309, 316 ¶ 8. In the case *sub judice*, the issue becomes whether this Court may adopt the default and summary judgment rendered by the state district court in determining the amount of the debt which may be excepted from discharge. In determining if a final judgment has been rendered on the merits, this Court must consider whether the damages or debt was actually litigated. Two issues arise: ". . . was the issue effectively raised in the pleadings or through development of the evidence and argument at trial or on motion; and, second, that the losing party had a 'full and fair opportunity' procedurally,

substantively, and evidentially to contest the issue in a prior proceeding." *Lane*, 296 Mont. at 280, 989 P.2d at 317 ¶ 41. If the default judgment merely restates the allegations of the pleadings, without a party having a full and fair opportunity to procedurally, substantively and evidentially contest the issues concerning the damages or debt, then that issue has not been actually litigated. *Id.* at ¶¶ 42, 43. Based on *Lane*, the damages or debt remain a question of fact. No other portion of the default and summary judgment has been alleged to have determined any elements of fraud critical to this Court consideration of the five elements of fraud required under 11 U.S.C. § 523(a)(2)(A).

> To be a final judgment under the second prong, the issue must have been "actually litigated and adjudged as shown by the face of the judgment." *Lane v. Farmers Union Ins.*, 989 P.2d at 317 (internal quotation marks omitted). In the case of a default judgment, the issues are not actually litigated, and accordingly, "a default judgment generally carries no collateral estoppel effect." Id. at 316; *accord* RESTATEMENT (SECOND) OF JUDGMENTS § 27, cmt. e (1982)(collateral estoppel does not apply to a default judgment because the issues are not actually litigated").

Morris, 252 B.R. at 47-48 (interpreting Montana law). The Court concludes by ¶ 1of the Findings of Fact contained in the state court order and judgment, dated February 12, 2004 that a default was entered against Defendant Julia Sauter, and by ¶ 2 of the Findings of Fact that a summary judgment as to liability against Defendant Sauter was entered, and correspondingly, a default judgment and a summary judgment as to damages were entered against Defendants Julia Sauter and Duane Sauter, respectively.

DISCUSSION

Given the foregoing law, the Court concludes that issues of fact remain for trial. Summary Judgment in favor of Plaintiff is inappropriate given such issues of fact. By statements

made in Defendant Julia Sauter's affidavit, factual questions exist concerning the policy cancellation, who provided insurance coverage information to Mary Kelly and whether Ms. Kelly justifiably, not reasonably, relied on such information, and whether such questions of fact constitute fraud attributable to these Defendants. Further, a question remains as to damages as collateral estoppel is not available to determine damages given the default and default judgment against Defendant Julia Sauter. Also, the issues decided in the prior state court litigation involved allegations concerning breach of contract and breach of the covenant of good faith and fair dealing, not fraud, so are the issues and damages decided by summary judgment against Defendant Duane Sauter in the state court litigation identical with the issues presented in the case *sub judice,* that is, are the damages attributable to a breach of contract and a breach of the covenant of good faith and fair dealing, or to fraud or to both? Such inquiry involves a question of fact.

Based upon the forgoing,

IT IS ORDERED that a separate order will be entered denying Plaintiff's motion for summary judgment; that the hearing scheduled on the motion for summary judgment for May 5, 2005, at 1:30 p.m. in Missoula, Montana, is vacated; that the parties shall be prepared to commence trial of this proceeding, as set by previous order, on **May 5, 2005, at 01:30 p.m.**, or as soon thereafter as counsel can be heard, in the BANKRUPTCY COURTROOM, RUSSELL SMITH COURTHOUSE, 201 EAST BROADWAY, MISSOULA, MONTANA; that a pretrial order shall be filed with the Court on or before **May 4, 2005**; Plaintiff's counsel shall be responsible for preparing the pretrial order and arranging the meeting of counsel attendant thereto; that on or before **May 4, 2005**, each party shall file with the Court and serve

upon opposing counsel or parties: (a) a list identifying by name and address all prospective witnesses, including specifying all expert witnesses; and (b) a list of all proposed exhibits, together with a copy of each exhibit duly marked and identified as the party's proposed exhibit (by number for the Plaintiff and by letter for the Defendant); that each party may file and serve a short pretrial memorandum with the Court on or before **May 4, 2005**, containing a brief description of the issues of fact and/or law, the party's theories of the case, and a discussion of applicable authorities for such positions; and that a motion for continuance of trial will not be granted unless good cause is shown.

BY THE COURT

HON. RALPH B. KIRSCHER
U.S. Bankruptcy Judge
United States Bankruptcy Court
District of Montana